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Report to the Chairman, Subcommittee on Oversight of Government Management and the District of Columbia, Committee on Governmental Affairs, U.S. Senate

May 1996

CONCESSIONS CONTRACTING

DOD Military Exchange Services' Rates of Return

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CONCESSIONS CONTRACTING: DOD MILITARY EXCHANGE SERVICES' RATES OF RETURN

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May 9, 1996

The Honorable William S. Cohen
Chairman, Subcommittee on Oversight
of Government Management and the
District of Columbia
Committee on Governmental Affairs
United States Senate

Dear Mr. Chairman:

This report is in response to your request for us to provide information on concessions contracting in the Department of Defense's (DOD) three military exchange services. You requested that we determine (1) the extent of centrally managed concessions operations in DOD's military exchange services, (2) the rate of return from centrally managed concessions operations and factors that affected the rate of return, and (3) how the exchange services' rates of return compared to other agencies' or governments' rates of return from concessions. Because of data availability and time considerations, you asked that we not include this information in our report on the concessions activities of 75 federal civilian agencies, which we provided to you earlier.[1]

Results in Brief

The 3 DOD exchange services reported 27 centrally managed concessions agreements in effect during fiscal year 1994. Concessions are generally businesses that use a government's property to provide services to the general public or specific individuals and share the profits with the government. The centrally managed concessions for DOD's exchanges are contracts that are negotiated and procured at the headquarters level. The reported gross revenues from these concessions were $273.5 million in fiscal year 1994. Concessioners paid the exchange services a reported $57.7 million from their concessions revenues, for an overall rate of return of 21.1 percent.[2]

The exchange services' 21.1 percent overall rate of return for fiscal year 1994 was higher than the fiscal year 1994 average 3.6 percent overall rate for civilian agencies that we calculated on the basis of data received from civilian agencies. The exchange services' information also showed a higher rate of return than the average rate reported by other governments we

[1]See Concessions Contracting: Governmentwide Rates of Return (GAO/GGD-96-86, April 29, 1996).

[2]From financial information the exchanges reported, we calculated the rate of return by dividing reported concessions fees by reported gross revenues.

surveyed, including Canada, California, Maryland, Michigan, and Missouri, which reported a 12.7 percent average rate of return. Our review of the overall concessions area revealed that two key factors affecting the rate of return were the use of competition in selecting concessioners and agencies' authority to retain concessions fees. DOD's policy requires exchange services to procure concessions services primarily through competitive negotiation. The exchanges reported that 9 of the 27 centrally managed concessions contracts were awarded or extended in fiscal year 1994, and competition was used in 6 of these 9 contracts. The exchanges also retain all fees received from concessions operations to support DOD morale, welfare, and recreation programs for military members and their families.

Background

For the purpose of this assignment, we defined "concessions" as private or public entities using federally owned/leased property under a government contract, permit, license, or other similar agreement to provide recreation, food, or other services to either the general public or specific individuals.

Military exchanges are nonappropriated fund activities that are established and controlled by, and operated for the benefit of, DOD components. They maintain control and custody over their activities' proceeds, which are used to fund their operations. The military exchanges have a dual mission of providing (1) authorized patrons with articles and services necessary for their health, comfort, and convenience; and (2) a source of funding for DOD morale, welfare, and recreation (MWR) programs. DOD has three military exchange services providing service on a worldwide basis. They are the Army and Air Force Exchange Service, the Navy Exchange Service Command, and the Marine Corps MWR Support Activity.

The primary purposes of the exchange services' concessions program are to provide (1) services to military personnel and their families at the best possible prices and (2) revenues in the form of concessions fees to support programs that directly benefit service members. Concessions contractors are provided space at the exchanges to supply a particular concessions service to exchange customers. The exchanges receive commissions from the concessioners, expressed as a percentage of sales receipts.

Objectives, Scope, and Methodology

The objectives of our review were to determine (1) the extent of centrally managed concessions operations in DOD's military exchange services, (2) the rate of return from the centrally managed concessions operations

and factors that affected the rate of return, and (3) how the exchange services' rates of return compare to other agencies' or governments' rates.

To accomplish objectives one and two, we (1) sent a questionnaire to DOD requesting general information on its exchange services' centrally managed concessions agreements and detailed information, such as whether the agreement was competed, on centrally managed concessions that the exchanges either awarded or extended in fiscal year 1994; (2) interviewed officials from the three exchange services; and (3) reviewed DOD's policies and regulations relating to the exchange services' concessions operations.

Our information about the concessions agreements comes from the agencies' questionnaire responses for the agreements. To check whether the questionnaires were filled out completely and accurately, we (1) manually reviewed all pages of each form, (2) checked selected responses against copies of the concessions agreements that agencies sent to us, and (3) followed up with agency staff in selected cases to clarify their responses. However, we did not verify the accuracy of data provided by agencies or other governments.

To accomplish objective three, we compared DOD's information with information we received from a survey of 75 federal and civilian agencies, 4 states, and Canada. The survey information is reported in our previously cited report on concessions.

We did our review of the exchange services from November 1995 to February 1996, in accordance with generally accepted government auditing standards. All of our work was done in Washington, D.C. On April 2, 1996, we provided a draft of this report to the Secretary of Defense for comment. On April 8, 1996, we discussed the draft report with the Assistant Director, MWR and Resale Activities, Office of the Assistant Secretary of Defense (Force Management Policy). His comments are discussed on page 6.

Extent of Concessions in the Military Exchange Services

As shown in table 1, the 3 DOD exchange services reported 27 centrally managed concessions agreements in effect during fiscal year 1994. The reported concessioners' gross revenues from these concessions were $273.5 million.

Table 1: Reported Centrally Managed Concessions Agreements With the Military Exchange Services in Fiscal Year 1994

Agency	Number of centrally managed agreements	Concessioners' revenue (in millions)	Concessions fees (in millions)	Rate of return (percent)
Navy Exchange Service Command	16	$161.9	$32.8	20.2
Army Air Force Exchange Service	7	89.7	19.8	22.1
Marine Corps MWR Support Activity	4	21.9	5.1	23.3
Total	**27**	**$273.5**	**$57.7**	**21.1**

Source: GAO questionnaire data.

Reported services provided by the exchanges' concessioners included income tax preparation, food service operations, truck rental services, and telegraphic services and equipment.

From the reported information, we computed an overall rate of return of 21.1 percent that the exchanges received from centrally managed concessions operations in fiscal year 1994. We calculated this rate by dividing the reported concessions fees of $57.7 million by the reported gross revenues of $273.5 million earned by the concessioners.

Analysis of questionnaire data showed that the exchange services' fiscal year 1994 overall 21.1 percent rate of return was higher than the civilian agencies' fiscal year 1994 average overall rate of 3.6 percent. We calculated the civilian agencies' rate from information reported by 42 agencies or agency components. The exchange services' rate was also higher than the average rate of other governments we surveyed, including Canada, California, Maryland, Michigan, and Missouri, which reported an average 12.7 percent overall rate of return. The states reported that they received rates of return ranging from 11 to 17 percent, while Canada's overall reported rate was 9.8 percent.

Military Exchange Services' Management of Concessions

Exchanges' centrally managed concessions contracts are agreements that are negotiated and procured by the headquarters level of the exchange service. These centrally managed concessions are dispersed throughout the world for use by military members and their families at the many military installations. Although these concessions are to be procured from

a central location, according to exchanges' officials, oversight is performed at the local level using applicable DOD directives.

Although the competition requirement of the Armed Services Procurement Act and the Federal Acquisition Regulation do not apply to exchange concessions because of the exchanges' status as nonappropriated fund activities, DOD policies require competition to the extent possible. DOD policy requires that procurements using nonappropriated funds be accomplished primarily through competitive negotiation; by trained procurement personnel; in a fair, equitable, and impartial manner; to the best advantage of the applicable DOD organization.

The exchanges reported that 9 of the 27 centrally managed concessions were awarded or extended in fiscal year 1994. They reported that (1) competition was used to select six of the nine concessions contractors, (2) two contracts were based on unsolicited offers submitted by the contractors, and (3) one concessions contract was awarded as a sole-source contract after a determination that it was the only source able to provide the required level of service.

The military exchanges' concessions policies do not incorporate two factors that reduce competition and are required by legislation for some civilian concessions. First, the exchanges' policies do not provide for preferential treatment to the incumbent concessioner when a contract expires. In contrast, for certain civilian agency concessioners, legislation provides for preferential right of contract renewal to the existing concessioners when the contract expires in order to encourage continuity of service. Second, the exchanges' policies do not grant concessioners the right to be compensated for improvements to property and/or for property they construct on federal land. However, legislation requires that certain civilian agency concessioners be compensated for improvements they make to facilities on federal property. Civilian agency officials said this practice reduces the number of bidders because either the agency or successor concessioner has to pay the incumbent concessioner reconstruction costs less depreciation for the improvements, not to exceed fair market value.

According to the exchanges, if a concessioner makes improvements to or constructs a building (other than portable or relocatable structures), the government assumes immediate ownership when the government approves the building. To assist concessioners in recouping their investment, the exchanges said they will agree to a long-term contract,

lasting from 10 to 25 years. However, if for any reason the concessioner does not perform for the entire length of the contract period, the government is to retain sole ownership of the facility.

Exchange concessioners are to retain title to their furniture, equipment, and movable fixtures. Under the exchange services' policies, the exchanges are not liable to concessioners for the costs of concessioners' investment in such items. At the end of a contract, the contractor has the option of removing all furniture, fixtures, and proprietary equipment.

The exchanges also retain and control all concessions fees received from concessions operations. According to questionnaire data, the retained fees are used to (1) offset concessions' operating expenses, (2) support MWR programs for military members and their families, and (3) cover capital improvement expenses.

Agency Comments

On April 2, 1996, we provided copies of a draft of this report to the Secretary of Defense for comment. On April 8, 1996, we discussed the draft report with the Assistant Director, MWR and Resale Activities, Office of the Assistant Secretary of Defense (Force Management Policy). He said DOD concurred with the facts and findings in the report and had no further comments.

As arranged with your office, unless you release its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies of the report to interested congressional committees, the agencies included in our review, the Director of the Office of Management and Budget, and other interested parties. We will also make copies available to others upon request.

Major contributors to this report were John S. Baldwin Sr., Assistant Director; Lucy M. Hall, Evaluator-in-Charge; Abraham L. Logan, Staff Evaluator; and Jill P. Sayre, Senior Attorney. Please contact me on (202) 512-8387 if you have any questions concerning this report.

Sincerely yours,

J. William Gadsby
Director, Government Business
Operations Issues